IN THE COURT OF APPEALS OF TENNESSEE
AT NASHVILLE
January 8, 2010 Session

LUTHER THOMAS SMITH v. LESLIE NEWMAN, COMMISSIONER, TENNESSEE DEPARTMENT OF COMMERCE AND INSURANCE

Appeal from the Chancery Court for Davidson County
No. 08-972-II Carol L. McCoy, Chancellor

No. M2009-00636-COA-R3-CV - Filed March 24, 2010

Insurance producer, licensed in Tennessee, sold high-value life insurance policies on behalf of an insurance company and, through a premium financing company he controlled, loaned the amount of the first-year premiums on those policies to his policyholders; insurance company paid insurance producer a commission of at least 105% of the first-year premium on the policies he sold. The Commissioner of the Tennessee Department of Commerce and Insurance found that insurance producer was rebating premiums and was engaging in dishonest practices in violation of applicable statutes; insurance producer's license was revoked and he was assessed a fine of $30,000.00. Insurance producer sought judicial review and the trial court affirmed the Commissioner's decision. Finding that the trial court properly applied the standard for reviewing the Commissioner's decision and that the revocation and fine are supported by the evidence, the judgment is affirmed.

Tenn. R. App. P. 3 Appeal as of Right; Judgment of the Chancery Court Affirmed

RICHARD H. DINKINS, J., delivered the opinion of the court, in which FRANK G. CLEMENT, JR., and ANDY D. BENNETT, JJ., joined.

John C. Lyell, II, Nashville, Tennessee, for the appellant, Luther Thomas Smith.

Robert E. Cooper, Jr., Attorney General and Reporter, Michael E. Moore, Solicitor General, Laura T. Kidwell, Senior Counsel, and Sarah A. Hiestand, Senior Counsel, for the appellee, Tennessee Department of Commerce and Insurance.

OPINION

I. Procedural and Factual Background

Between April 1999 and February 2003, Luther Thomas Smith, an insurance producer licensed in Tennessee, sold 30 whole-life insurance policies on behalf of Ohio National Life Insurance Company ("Ohio National"). Eagle Financial Group, Inc. ("Eagle"),[1] a premium financing company, loaned the amount of the first-year premium to Mr. Smith's policyholders, who executed a promissory note payable to Eagle for the amount of the loan; the policyholder used the funds to pay Ohio National the first-year premium. Ohio National paid Mr. Smith a commission of at least 105% of first-year premiums paid on the policies he sold; during the applicable time period, Ohio National paid Mr. Smith $2,470,414.00.

At some point, Ohio National's auditors noticed some anomalies in the policies written by Mr. Smith, including a reduction in their value and a lapse of 28 of the 30 policies within their first three years.[2] On September 28, 2005, the Insurance Division ("Division") of the Tennessee Department of Commerce and Insurance ("Department") filed a First Amended Petition[3] with the Commissioner of Commerce and Insurance ("Commissioner") against Mr. Smith, alleging that he engaged in the unfair trade practice of premium rebating in violation of Tenn. Code Ann. § 56-8-104(D)(7) (2001) and used dishonest practices in violation of Tenn. Code Ann. § 56-6-155(a)(8) (2001).[4] The Division sought to revoke Mr. Smith's license and to assess a civil penalty pursuant to Tenn. Code Ann. § 56-6-155(b).

After a period of discovery, each party filed a motion for summary judgment. On April 2, 2007, the Administrative Law Judge ("ALJ") issued an order granting the Division's motion and denying Mr. Smith's motion, finding that Mr. Smith engaged in premium rebating and dishonest practices in violation of the applicable statutes. On April 16 Mr.

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[1] Eagle is owned by Eagle Financial ESOP Trust, an Employee Stock Ownership Plan in which employees own stock in the company. Mr. Smith is the sole trustee and manager of the ESOP Trust.

[2] Ohio National filed suit in the United States District Court for the Middle District of Tennessee against Mr. Smith for breach of contract, fraud, and violation of the Tennessee Consumer Protection Act.

[3] The Division filed an original Petition on April 21, 2005, in which it alleged violations of certain statutes as they are currently codified. The First Amended Petition restated, verbatim, the factual allegations made in the original Petition, but alleged violations of the statutes as codified at the time of the underlying conduct. The citations in this opinion are to the codification of the relevant statutes at the time the events took place.

[4] The Division asserted other statutory violations against Mr. Smith, however, the Division's motion for summary judgment, upon which this appeal is based, focused solely on these two allegations.

Smith filed a motion to reconsider, which was denied by the ALJ on August 16. On that date a separate order was entered by the ALJ revoking Mr. Smith's license and assessing a civil penalty of $1,000.00 for each of the 30 violations, for a total penalty of $30,000.00.[5]

On August 28, 2007, Mr. Smith filed an appeal with the Commissioner, challenging the ALJ's orders denying his motion to reconsider and assessing sanctions.[6] On March 6, 2008, the Commissioner entered a Final Order, affirming the ALJ's orders and incorporating those orders into the Final Order. On April 29 Mr. Smith filed a Petition for Judicial Review, asserting that the Final Order was "in violation of constitutional provisions, [was] arbitrary and capricious, and...was unsupported by evidence which was substantial and material in light of the entire record."[7] On February 27, 2009, the trial court issued an order affirming the Final Order, finding that the ALJ "properly found that Mr. Smith engaged in dishonest practices" and that "[t]he Final Order [wa]s supported by substantial and material evidence." Mr. Smith appeals and raises a number of issues, summarized as follows:

> 1. Whether the charges of premium rebating should have been brought against Eagle, not Mr. Smith, since Eagle made the loans to his policyholders.
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> 2. Whether the trial court erred by not finding that the Commissioner's decision was in violation of statutory provisions or was arbitrary and capricious because Mr. Smith was legally financing premiums pursuant to Tenn. Code Ann. § 56-37-101, *et. seq*. (2001) and was not engaged in premium rebating, as found by the Commissioner.
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> 3. Whether the trial court erred by not finding that the Commissioner's decision was unsupported by evidence that is both substantial and material in light of the entire record.

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[5] The order imposing sanctions recited, in pertinent part, as follows:

> ... the Respondent engaged in an insurance policy rebating scheme over several years, involving multiple insurance companies and multiple clients. The Notice of Charges in this case only charged the respondent with conduct related to his representation of Ohio National Life Insurance Company ("Ohio National"). He sold thirty (30) policies on behalf of Ohio National, employing his rebating scheme, and to the detriment of Ohio National.

[6] The exact language of the appeal to the Commissioner was that "Respondent...appeals the Initial Order entered on August 16, 2007 resulting from a motion for reconsideration of an order granting partial summary judgment filed on April 16, 2007."

[7] Mr. Smith and the Division entered into an Agreed Order to Stay Pending Appeal, which was signed by the Commissioner on May 29, 2008, and made part of the administrative record.

II. Standard of Review

Review of an administrative decision is governed by the narrow standard set forth at Tenn. Code Ann. § 4-5-322. A court may reverse or modify a commissioner's decision if the rights of the petitioner have been prejudiced by administrative findings, inferences, conclusions or decisions that are:

> (1) In violation of constitutional or statutory provisions;
> (2) In excess of the statutory authority of the agency;
> (3) Made upon unlawful procedure;
> (4) Arbitrary and capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion; or
> (5)(A) Unsupported by evidence that is both substantial and material in the light of the entire record.

Tenn. Code Ann. § 4-5-322(h).

In reviewing a decision under the Administrative Procedures Act, the court must engage in a three-step analysis. First, the court must determine whether the appropriate legal principles were identified. *McEwen v. Tennessee Dept. of Safety*, 173 S.W.3d 815, 820 (Tenn. Ct. App. 2005). Second, the court must determine whether the findings in the decision are supported by substantial and material evidence. *Id*. Finally, the court must examine how the law was applied to the facts. *Id.* The final step of this analysis involves mixed questions of law and fact; therefore, the courts must give deference to the decision maker. *Miller v. Civil Serv. Comm'n*, 271 S.W.3d 659, 665 (Tenn. Ct. App. 2008) (citing *Armstrong v. Metro Nashville Hosp. Auth*., No. M2004-01361-COA-R3-CV, 2006 WL 1547863, at *2 (Tenn. Ct. App. June 6, 2006)). Accordingly, the court must determine whether the decision is supported by "such relevant evidence as a rational mind might accept to support a rational conclusion." *Clay County Manor v. State Dep't of Health & Env't*, 849 S.W.2d 755, 759 (Tenn. 1993); *Southern Ry. v. State Bd. of Equalization*, 682 S.W.2d 196, 199 (Tenn. 1984).

"When reviewing a trial court's review of an administrative agency's decision, this Court essentially is to determine 'whether or not the trial court properly applied...the standard of review' found at Tenn. Code Ann. § 4-5-322(h)." *Jones v. Bureau of TennCare*, 94 S.W.3d 495, 501 (Tenn. Ct. App. 2002) (quoting *Papachristou v. Univ. of Tennessee*, 29 S.W.3d 487, 490 (Tenn. Ct. App. 2000)).

III. Analysis

A. Eagle

Mr. Smith asserts that the Division should have brought charges against Eagle, not him, because Eagle loaned the funds to finance the premiums of his policyholders and, therefore, would be responsible for any violations of the premium financing statute found at Tenn. Code Ann. § 56-37-101, *et. seq*. This assertion is unfounded.

The Division did not allege that the loans or the way in which they were obtained violated the premium financing statute; neither was the proceeding against Mr. Smith based on the ground that the premiums were *financed* by loans.[8] Rather, the proceeding was based on the contention that the failure of Mr. Smith to collect on the promissory notes resulted in an improper *rebating* of the premiums. As will be discussed in more detail below, "rebating" is defined, in part pertinent, as the "paying or allowing, or giving or offering to pay, allow, or give, *directly or indirectly,* as inducement to such insurance, any rebate of premiums payable on the contract." Tenn. Code Ann. § 56-8-104(D)(7) (emphasis added). As evidenced by his deposition testimony and his response to the Division's Statement of the Undisputed Facts, Mr. Smith, the sole trustee of the ESOP Trust that owned and controlled Eagle, on behalf of Eagle, issued promissory notes which were executed by his policyholders to evidence the loans used to finance the premiums for their policies. The acts of Mr. Smith were alleged to constitute, in part, violations of the premium anti-rebating statute; they were related to but independent of Eagle's acts and were not affected by the fact that separate charges were not brought against Eagle for violation of the premium financing statute.

B. Applicable Statute

Mr. Smith asserts that the Commissioner's "conclusions and decisions were not based on the proper statute" because the Commissioner "failed to give due credence to the controlling statute concerning insurance agents making premium financing loans"; specifically, he contends that he was financing the first-year premiums of his policyholders in compliance with an exemption to the requirements of the premium financing statute at Tenn. Code Ann. § 56-37-101, *et. seq.* and that the Commissioner incorrectly applied the

[8] As noted by counsel for the Department at argument, enforcement of the premium financing statute is vested in the Commissioner of Financial Institutions, rather than the Commissioner of the Department of Commere and Insurance. *See* Tenn. Code Ann. § 56-37-105.

premium anti-rebating statute at Tenn. Code Ann. § 56-8-104 to his conduct.[9] Mr. Smith also argues that, if both statutes are applicable to the conduct at issue, the financing of premiums statute, because it is a specific statute, must prevail over the more general anti-rebating of premiums statute. We agree with the trial court that Mr. Smith was properly charged with violations of the premium anti-rebating statute. Mr. Smith's contention that the premium financing statute and the exemption contained therein apply to his conduct is erroneous.

The Premium Finance Company Act of 1980[10] authorizes a person licensed as a premium finance company to enter into premium finance agreements.[11] Tenn. Code Ann. § 56-37-103. A premium finance agreement is "an agreement by which an insured...promises to pay to a premium finance company the amount advanced...under the agreement to an insurer or to an insurance agent in payment of premiums of an insurance contract, together with interest and a service charge as authorized and limited by th[e] chapter." Tenn. Code Ann. § 56-37-102(4). The requirements of this chapter, however, "do[] not apply to...[a]ny insurance agent or producing agent licensed to do business in this state who finances premiums on policies solely written by such agent or producing agent." Tenn. Code Ann § 56-37-114(3). In order for the premium financing statute to apply and for Mr. Smith to be entitled to claim the exemption at Tenn. Code Ann § 56-37-114(3), he would have to be the "person" who financed the premiums. The record is clear, however, that Eagle was the "person" providing financing.[12]

Mr. Smith was an insurance producer licensed by the Department; responsibility for regulation of his conduct as such producer was vested in the Commissioner pursuant to Tenn. Code Ann. § 56-6-155 (currently codified as amended at Tenn. Code Ann. § 56-6-112). The acts upon which the proceeding was based were properly alleged to constitute violations of the statutes that the Commissioner is obligated to enforce.

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[9] At oral argument, Mr. Smith's counsel summarized the main issue before this Court as whether Mr. Smith was financing premiums in compliance with the premium financing statute or was rebating premiums in violation of the premium anti-rebating statute.

[10] Tenn. Code Ann. § 56-37-101, *et. seq.*

[11] The statute defines "person" as "an individual, partnership, association, business corporation, nonprofit corporation, common law trust, joint-stock company or any other group of individuals however organized." Tenn. Code Ann. § 56-37-102(3).

[12] As a result of our finding that the Premium Finance Company Act is inapplicable to this matter, Mr. Smith's contention regarding specific statutory authority prevailing over general statutory authority is pretermitted. *See Brewer v. Lincoln Brass Works, Inc.*, 991 S.W.2d 226, 229-30 (Tenn. 1999) ("Specific statutory provisions generally prevail over general provisions *when there is a conflict between statutes*.") (emphasis added).

C. Substantial and Material Evidence

The next step in a court's review of an agency's decision is to "examine the agency's factual findings to determine whether they are supported by substantial and material evidence." *McEwen*, 173 S.W.3d at 820.

"While this Court may consider evidence in the record that detracts from its weight, [this] [C]ourt is not allowed to substitute its judgment for that of the agency concerning the weight of the evidence." *Jones*, 94 S.W.3d at 501 (quoting *Gluck v. Civil Serv. Comm'n*, 15 S.W.3d 486, 490 (Tenn. Ct. App. 1999)). "'Substantial and material evidence' consists of such relevant evidence as a reasonable mind might accept as adequate to support a rational conclusion." *McEwen*, 173 S.W.3d at 820 n.8. "Substantial and material evidence furnishes a reasonably sound basis for the agency's decision." *Id*.

In support of its motion for summary judgment, the Division submitted, among other things: the affidavit of Molly Akin, senior agency auditor for Ohio National; the deposition of Mr. Smith; interrogatories answered by Mr. Smith; and a Statement of the Undisputed Material Facts. In support of his motion for summary judgment, Mr. Smith submitted his affidavit and a Statement of Undisputed Facts.

In her affidavit, Molly Akin stated that, during a company review for a policy value reduction report, Ohio National's audit department noticed that Mr. Smith's business had an "elevated number of policies with reduced values" and "an elevated occurrence of lapsed or lapsed pending policies"; that 22 of the 30 policies sold by Mr. Smith lapsed before their third anniversary, with six policies lapsing in their third year; that Ohio National "was not able to profit from any of the policies sold by Mr. Smith"; and that Mr. Smith did not disclose to Ohio National "that the premiums on the policies he sold were paid by loans or other financing arrangements with the policy owners."

At his deposition, Mr. Smith testified that Ohio National did not pay him a commission until 30 days after the policyholder paid the premium on a policy and, consequently, that there would never be a situation where he could use a commission on a policy to finance the first-year premium of that policy. He stated that he did not know what action Eagle was going to take against the outstanding promissory notes. In response to the interrogatories submitted by the Division, Mr. Smith listed four policyholders who made partial payments on their promissory notes and noted that partial payments were made by other policyholders, but that he did not possess those records. In response to the Division's Statement of the Undisputed Material Facts, Mr. Smith admitted that he "did not disclose or

provide any documentation to Ohio National that the premiums on the policies he sold were paid by loans or other financing arrangements with policyholders" and that, "through companies he owns or exercises control, [he] issued promissory notes to finance premiums on behalf of policyholders"; Mr. Smith denied that only four policyholders made payments on their loans, that the policies he sold had a "tendency to lapse within three (3) years of the policy inception date," and that he took no action on the promissory notes.[13]

In his affidavit, Mr. Smith stated that he never split a commission with a policyholder; that he received $230,000.00 in payments on the promissory notes from four of the policyholders whose premiums he financed; that many of the insurance policies he sold did not lapse within three years; that he contacted some of the policyholders concerning "the debts owned to [him] on premium financing agreements"; that he would not receive a commission from Ohio National until 30 days after the policyholder paid the first-year premium on the policy; that Ohio National never "asked, or required [him] as their agent to inform them as to whether or not a customer had financed his premium [or] asked for the source of any premium payment"; and that his intent was for "persons financing insurance premiums with [him] [to] repay their loans one way or another including surrendering their policy to [him]." In his Statement of Undisputed Facts, Mr. Smith stated that he "never rebated to a purchaser of an Ohio National...policy any of the commission received from the sale of such policy" and that he had been paid at least $230,000.00 on the promissory notes that financed Ohio National policyholder's premiums.[14]

In the Initial Order, which was later incorporated into the Commissioner's Final Order, the ALJ held that Mr. Smith was "engaged in a rebate scheme disguised as a premium-financing transaction" and that he used dishonest practices by concealing the scheme from Ohio National. With regard to the premium rebating scheme, the ALJ found that, "through his premium financing company, [Mr. Smith] advanced to [the policyholders] sums of money equal to their policies' first-year premiums, with no expectation that the 'loan' would be repaid"; that, "[o]nce the insured used that advance to pay the premium, [Ohio National] paid a commission to Smith in an amount that was between 5% and 30% more than the amount of the premium"; and that, "since Smith did not seek repayment of the money advanced to the policy holders, they received the benefit of a large-value insurance policy for which they paid an extremely reduced premium, or no premium at all." The ALJ found this to be "the very essence of premium-rebating" since Mr. Smith was providing

[13] In making these statements, the Division cited to the evidence it submitted in support of its motion for summary judgment. In support of his denial of the statements, Mr. Smith provided no explanation and cited only to his affidavit.

[14] In support of these statements, Mr. Smith cited to his affidavit and to his answers to the Division's interrogatories. The record does not contain a response from the Division to these statements.

"other 'valuable consideration or inducement whatsoever' that [wa]s not spelled out in the insurance policy contract." Tenn. Code Ann. § 56-8-104(7)(A).

With regard to dishonest practices, the ALJ found that Mr. Smith benefitted from the "substantial commissions" he received from Ohio National; that the policyholders benefitted by "receiving high-value insurance policies they did not have to pay for"; that "[t]he only party to the transactions that did not benefit was [Ohio National]...[b]ecause of the high commissions being paid to [Mr.] Smith, and the fact that the policies lapsed within a short time"; and that, as a result, Ohio National realized no profit from the policies sold by Mr. Smith." The ALJ concluded that, "[b]ecause he concealed his prohibited activities from them..., Ohio [National] was unable to protect itself from the resulting negative consequences of his acts." The Commissioner adopted these findings and the trial court affirmed the Commissioner's decision, finding that substantial and material evidence existed in the administrative record to support the conclusion that Mr. Smith rebated premiums and engaged in dishonest practices.

Upon a review of the record, we find that the trial court did not err in finding that substantial and material evidence existed in the record to support the Commissioner's conclusions.[15] Mr. Smith admitted that he, through Eagle, loaned his policyholders the amount of their first-year premium and that Ohio National was not informed of the fact that the premiums were being financed. The record also shows that the agreement to finance the premium was not "plainly expressed in the insurance contract," as required by the statute. Furthermore, Mr. Smith made very few attempts to collect the "loans" evidenced by the promissory notes and, as a result, his policyholders paid little or no money in exchange for a high-value life insurance policy. Despite his failure to recoup the loans, Mr. Smith profited by receiving a commission of at least 105% of the amount of the first-year premium on the policies he sold; Ohio National, however, realized no profit from these transactions because the 30 policies Mr. Smith sold had a reduction in value and/or had lapsed. With deference given to the agency's judgment concerning the weight of the evidence, we find that the trial court did not err in finding that the record contained sufficient proof to furnish a reasonably

[15] Mr. Smith does contend that the Commissioner improperly relied upon a Bulletin, issued by the Department in 1994 which explained rebating and its consequences, as a legal basis for finding him to be in violation of the premium anti-rebating statute; he asserts that the Commissioner's reliance was improper because the Bulletin "was never made part of any law nor was it promulgated into a rule." The orders of the ALJ, the Commissioner, and the trial court all state the statutes and case authority relied upon and there is no indication that the Bulletin was treated as a legal basis upon which the finding of premium rebating rested; to the contrary, the finding relative to the Bulletin in the ALJ's order was that, because of its issuance, Mr. Smith "knew, or in the ordinary course of conducting his business, should have known, that his actions could result in administrative action."

sound basis for the agency's conclusion that Mr. Smith engaged in premium rebating and dishonest practices. *Jones*, 94 S.W.3d at 501.

D. Application of the Law to the Facts

Mr. Smith asserts that, since Ohio National did not pay him a commission on a policy he sold until 30 days after the policyholder paid the premium on that policy, there was never a situation where he could have used a commission he earned on a policy to rebate the premium on that policy.

The ALJ addressed this assertion in his order, concluding that, pursuant to Tenn. Code Ann. § 56-8-104(7)(A), "even an offer to provide undisclosed inducements to enter into an insurance contract is sufficient to constitute a 'rebate'" and that this statutory language does not require the rebate "be in cash" or "come directly from a commission." The ALJ held that the rebate need only be a "valuable consideration" and that Mr. Smith had provided such to his policyholders, a holding which was adopted by the Commissioner.

We find that the trial court did not err in affirming the Commissioner's determination that the failure to pursue collection of the promissory notes constituted an impermissible rebate of the premium. As was found by the ALJ, adopted by the Commissioner, and affirmed by the trial court, rebating includes offering to pay the premium on an insurance contract, or offering a valuable consideration not specified in the insurance contract, to induce the policyholder into buying the insurance. Tenn. Code Ann. § 56-8-104(D)(7). The statute further defines rebating as an offer to make an agreement not plainly expressed in the insurance contract. *Id*. The loan provided to Mr. Smith's policyholders served to induce the policyholders to enter into the insurance contract and the "loan" agreement was not expressly contained in the insurance contract. In addition, the failure of Mr. Smith to pursue efforts to collect the promissory notes was a valuable consideration to the policyholders for their purchase of the policy. We find that sufficient evidence exists to support the conclusion that the Commissioner reached a rational decision and we see no reason to deviate from the great deference given to the agency in reaching this decision. *McEwen*, 173 S.W.3d at 820.

IV. Conclusion

For the reasons set forth above, the trial court's judgment is AFFIRMED. Costs of this appeal are assessed against Mr. Smith for which execution may issue if necessary.

RICHARD H. DINKINS, JUDGE